

Memorandum

To: Honorable Mayor and City Council
From: Rye Finance Committee
Re: Tax Certioraris – Key Issues and Conclusions
Date: July 18, 2006

Issues

Tax certiorari is the process whereby a taxpayer claims refunds of property taxes paid to a government entity. The refund claim is based on data calling for a reduction in the government's assessment of the value of the relevant property. At the end of 2005, Rye property taxpayers had outstanding, unresolved claims for tax refunds from the city totaling \$3,993,339. At the end of 2005, the city's balance sheet showed \$999,424 "Designated" in the "Unreserved Fund Balance" (hereinafter called "tax certiorari reserves") to cover the liability for these tax refund claims.

The Finance Committee considered the following key questions:

- Were the tax certiorari reserves at the end of 2005 reasonable?
- What are the risks for near-term budgets?
- What is the status of the largest refund claim?
- Is any action by the Council required or recommended at this time?

Conclusions

The tax certiorari reserves of \$999,424 as of 12/31/05 provided reasonable coverage for the city's liability on that date. It reflected city staff estimates of the funds it would use for all future tax certiorari judgments and settlements for claims as of 12/31/05 based on a statistical analysis of all the claims it has paid. Refunds last year averaged 25% of claim amounts that were resolved and the tax certiorari reserve at year-end was 25% of unresolved claims. The city's accounting policy seems reasonable. No action by the Council is required or recommended now.

One claim represents approximately half the total of all tax refund claims and is before the courts, with a decision possible later this year. City management views the claimant's property as subject to taxation and does not view the probability of an adverse judgment any higher than other outstanding tax certioraris. However, a highly adverse court decision with so large a claim would have a larger impact than would be the case with any other claim. The following outcomes are possible:

- If the court judgment matches recent settlements, the tax certiorari reserve covers the liability, and coverage of other claims by the remaining tax certiorari reserve is adequate, i.e. no special impact on city budgets.
- If the court judgment approves all or most of claimant's refund claims, the city would have a major cash obligation - \$2 to \$2.5 million to pay to the claimant. However, the City can issue a bond to finance a substantial payment it might have to pay, spreading the cost burden over an extended period.
- If the court judgment rejects the claimant's claims entirely, the tax certiorari reserve would be double the amount required per recent claims paying experience, i.e. a possible

benefit for budgets or unreserved fund balances until tax certiorari reserves decrease to reflect claims paying experience.

There are differences in law between city and school district operations (such as legal limitations on unreserved fund balance), as well as governing board philosophy, that may explain higher percentage tax certiorari reserves carried by the Rye City School District.

The tax certiorari reserve will be revisited as part of the process of preparing the 2006 financial statements. Adjustments to the tax certiorari reserve at year end will most likely be required to reflect new tax certioraris, the resolution of existing claims (by settlement, judgment, or withdrawal), and any change in our claims payment experience. Claims increased \$1.2 million in 2005; a similar increase in 2006 would call for a tax certiorari reserve increase of \$300,000 - \$400,000 depending on whether claim payouts continue at 25% or approach prior year rates. Any increase in the amount "Designated" to cover tax certioraris reduces the "Undesignated Fund Balance."

Every refund claim that is approved has implications for tax revenues for future years. The tax roll carrying the burden of future taxes will be smaller than it might be otherwise, which results in a higher tax rate for all taxpayers than might otherwise be the case. Also, the taxpayers whose adjusted assessments are approved will be carrying a smaller share of the taxes than previously. For example, the single largest claimant noted above is also the city's largest taxpayer, accounting for 2.4% of total assessments. Any reduction in its assessment impacts other taxpayers in subsequent years.

Summary Data

<u>Year</u>	<u>Designated Tax Certiorari At Year End</u>	<u>Tax Certiorari Refund Claims At Year End ¹</u>	<u>Three Largest Claims</u>	<u>Tax Refunds Paid During The Year ²</u>	<u>Reserve/ Claim Ratio</u>	<u>Refunds/ Prior Claims</u>
2002	\$486,855	\$1,418,287	\$ 863,041 71,902 59,702	\$44,651	34%	
2003	\$550,043	\$2,069,305	\$1,136,651 104,541 103,199	\$55,454	27%	3.9%
2004	\$810,396	\$2,795,778	\$1,436,314 164,242 150,495	\$62,916	29%	3.0%
2005	\$999,424	\$3,993,339	\$1,812,877 227,110 224,336	\$64,781	25%	2.3%

¹ There were 68 claims pending on 12/31/05 of which 98%+ were commercial.

² 95-98% of the refunds were for commercial properties and mainly through negotiated settlements. Most residential reductions are considered by the Board of Assessment Review; any reductions it grants apply to following year's taxes.

The Tax Bill

The amount of a particular property's tax bill is determined by two things: 1) the property's taxable assessed value, which is determined by the assessor in each community, and 2) the tax rate of the locality in which the property is located. The assessment is based on the assessed value of the property. The tax rate is determined by dividing the amount required to be raised by taxes (the locality's budget anticipated costs, less revenues other than taxes and any amount of fund balance applied) by the taxable assessments of the municipality.

Property Assessment

The market value of a property is generally defined as what a property would sell for under normal conditions. For residential properties, the assessor generally determines market values by comparing a property with similar properties that have sold in similar neighborhoods, giving consideration to other factors possibly affecting market value. For commercial properties (including co-ops and condos), the assessor (as required by state law / precedence) determines values by estimating the rental value of the property using actual or comparative rental rates, actual or comparative property operating costs and capitalization rates. So, a condo's or co-op's assessment is based on its value as a rental property rather than the aggregate value of all units based on market sales prices.

Assessed Value vs. Market Value

In many communities, where assessments are maintained at a uniform percentage of 100, assessment is / equals market value. In other words, the assessed value would equal market value. Rye is one of many communities that is assessing at a fractional percentage of market value. Assessments in these communities should be based upon the same percentage being used throughout the community. For instance, if the market value of a home is \$1,000,000, and the community is assessing at 30% of market value, the assessment should be \$300,000. This year (i.e. Rye's 2005 assessment year / 2006 tax year) the governing percent is 2.35% based on 2005 tax assessments; so, if the market value of a home is \$1,000,000, and Rye is assessing at 2.35% of market value, the assessment should be \$23,500.

Equalization

Equalization rates seek to measure the relationship of locally assessed values to an ever-changing real estate market. Each year, New York State calculates equalization rates for each of the state's more than 1,200 assessing units. Equalization is necessary in New York State because: (1) there is no fixed percentage at which property must be assessed; (2) not all municipalities assess property at the same percentage of market value; and (3) taxing jurisdictions, such as most school districts, do not share the same taxing boundaries as the cities and towns that are responsible for assessing properties. Most of the state's more than 700 school districts (e.g. Rye Neck School District) use equalization rates to distribute their taxes among segments of two or more municipalities, many of which have different levels of assessment. County taxes are also allocated to individual properties in different communities based on the equalization rate for each municipality.

At its simplest, an equalization rate is the state's measure of a municipality's level of assessment. This is the ratio of total assessed value (AV) to the municipality's total market value (MV). The

municipality determines the AV; the MV is estimated by the state. The equalization rate formula is:

Total Assessed Value (AV) divided by Total Market Value (MV) = Equalization Rate

An equalization rate of 100 means that the municipality is assessing property at 100% of market value. However, Rye's assessor does not re-assess each property every year. Generally the same assessment is maintained from year to year in Rye even if property prices are increasing, unless the nature of the property has changed, or significant improvements have been made to the property. Accordingly, to ensure Rye properties are allocated county taxes reflecting current market values, the assessed values are adjusted by the equalization rate. As Rye's market prices have gone up while assessed values have generally remained unchanged, the equalization rate has decreased. Rye's equalization rate is only 2.35 for the *2005 assessment* year (the *2006 tax* year). It has decreased from when the rate was 5.30 for the 1998 assessment year (1999 tax year). In other words, Rye market values increased 125% in the period. The equalization rate primarily reflects residential property values. If the same assessment continues from year to year and property values increase, the equalization rate decreases – an indication that unadjusted assessments are becoming less and less an indicator of market values.

Questioning Assessed Value

There is a presumption that the assessment made by the assessor is correct. The burden of proof for a change is on the property owner. If a property owner has questions about the assessment, whether it has been changed or not, he/she can consult the assessor for an explanation. If there is still dissatisfaction after meeting with the assessor, the owner has the right to file a formal claim for a refund for a specific dollar amount with the assessor's office. A claim for any year must be filed in that year. If the claim is not resolved that year, the claim carries over to the next year.

Residential property owners wanting the city's Board of Assessment Review ("Board") to consider their claim in the current year must meet a filing deadline (the 3rd Tuesday in June in Rye) for consideration by the Board. The Board then meets over the summer to deliberate petitions. If the property owner is dissatisfied with the Board's decision, a claim can be filed in small claims court. In either case, documentation required for such appeals is limited and the bulk of all residential claims are resolved in the year a claim is submitted.

Commercial property owners must also file claims before the 3rd Tuesday in June if they want a tax refund for that year. Resolution of these claims must be in New York State Supreme Court or through negotiation with the Assessor. Because the courts are backlogged with cases, there are long delays (years) in resolving cases through the courts and there is incentive to work out values with the assessor. A commercial property owner will often have several years of claims outstanding before his/her situation is resolved. Ninety-nine percent of all claims for refunds outstanding at the end of each year are claims by commercial property owners. A complex process is required for consideration of commercial cases, including formal appraisals, rules of evidence, etc.

Commercial property owners in Rye – especially large property owners – are more likely to claim refunds than residential property owners. Residential values have been increasing faster

than commercial values. Generally, neither residential nor commercial assessed values are adjusted annually, so commercial property owners claim that their assessments grow to a higher percent of their market value than do residential properties. In other words, commercial property owners say they are over-valued for the taxation calculation. Also, Rye's equalization rate, which is used to adjust assessed values to market values, is primarily determined by residential property values. As a result, commercial property owners claim that using (actually or implicitly) the same equalization rate for commercial properties overstates their value.

Refund claims that are approved average 25% of the refund claimed.

Rye's Largest Taxpayers & The Osborn

A list of the largest taxpayers in Rye may be found on page 108 of the statistical section of Rye's comprehensive annual report for 2005. The Osborn is the largest taxpayer in 2006, and it has been the largest claimant for refunds in the past four years. The Osborn has refund claims going back to 1998. Including their claim for 2006, they are looking for refunds of all taxes paid totaling \$2,195,198. If that amount were to be approved, the interest owing would be something like \$350,000 to \$400,000. The Osborn claims it should be fully exempt from property taxes and that the city has valued its property incorrectly. The Osborn's claims are being considered by the courts. The court is expected to rule later this year. It can decide whether a) The Osborn is fully exempt, not exempt at all or partially exempt and b) the appropriate value of the property if it is not fully exempt.

Respectfully submitted,

- *Rye Finance Committee*